

LIEN STRIPPING

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I. DEFINITIONS:

- A. Stripping Down: Process the debtor uses when the lien is undersecured. The claim is bifurcated into a secured portion and an unsecured portion, consistent with a Section 506 (a) valuation of the collateral. The debtor would then avoid the lien as to the unsecured portion of the claim, pursuant to Section 506 (d).
- B. Stripping Off: Process the debtor uses when the secured claim is not secured by any value against the property despite the existence of the lien. The claim is therefore, not an allowed secured claim pursuant to 506 (a), and the debtor can avoid the lien, pursuant to 506 (d). It is important to note that if a creditor can establish that there is one dollar worth of equity in the underlying collateral that secures its claim, then the debtor cannot avoid that lien.

CHAPTER 13

II. MAJORITY VIEW (Maryland):

- A. Rule of Law: A lien may be stripped off from a debtor's principal residence if it is wholly unsecured.
1. Unsecured claim: Exists when there is no value in the underlying collateral, regardless of the existence of a lien.
 2. Secured claim: A claim that is secured by some value in the underlying collateral is considered to be an allowed secured claim.
- B. Case Law:
- Maryland Cases:
1. **Johnson v. Asset Management Group, LLC, 226 B.R. 364 (D.Md. 1998):**
FACTS:
 - The debtor's property was valued in an amount that was less than the amount owed to the first priority creditor.
 - The debtor objected to the second creditor's proof of claim, alleging that the interest was wholly unsecured.RULING:
 - The Court may strip a lien if it is wholly unsecured due to valuation as per Section 506(a).
 - Bankruptcy should not allow remedy under Ch.13 that does not exist in fact upon foreclosure.
 2. **In re Walker, 1999 WL 641894 (Bankr.D.Md.):**
FACTS:
 - Creditor filed a proof of claim for unpaid homeowner's dues.

--Debtor objected to POC and sought to avoid the lien, alleging that the 1st priority creditor's claim exceeded the value of the principal residence of the debtor.

RULING:

--May strip lien if wholly unsecured.

--Adopted Johnson case.

Virginia Cases:

3. **Wright v. Commercial Credit Corp., 178 B.R. 703 (E.D.Va. 1995):**

FACTS:

--Debtor sought to modify creditor's right in the principal residence lien by listing the lienholder as an unsecured creditor in the debtor's proposed Ch. 13 plan.

--The creditor objected to the debtor's proposal and the Court remanded for a hearing to determine whether the lien was secured or unsecured.

RULING:

--The Court may strip a lien if it is wholly unsecured.

--The prohibition against lien stripping only applies when the debtor has some equity in the principal residence, after satisfaction of prior liens, to at least partially secure the creditor's claim.

4. **Flowers v. First Plus Financial, Inc., 1999 WL 118022 (Bankr.E.D.Va.):**

FACTS:

--Debtor's property was valued in an amount that was less than the amount owed to the first priority creditor.

--Debtor filed an adversary complaint to avoid the second creditor's claim, alleging that the lien was wholly unsecured.

RULING:

--The Court allowed the lien to be stripped off as there was no underlying value, rendering the lien wholly unsecured.

--A lien is not "secured" if no value attaches to the collateral.

--Section 506 (a) defines a secured claim as secured only to the extent of the value of the creditor's interest in the property.

--The Court rejected the argument that a secured claim means solely a claim for which a lien exists to secure such claim.

Third Circuit Case:

5. **McDonald v. Master Financial, Inc., 205 F.3d 606 (1999):**

FACTS:

--Debtor brought adversary proceeding against junior creditor alleging that the lien was wholly unsecured and not subject to antimodification principles.

RULING:

- The Court may strip the lien if it is wholly unsecured.
--The lien is a secured claim only to extent of the value of creditor's interest in the property and is unsecured to the extent that it exceeds the property value.
--A creditor with a dollar worth of security in the property can prevent the lien from being stripped off.

- C. **A lien may not be stripped down on a principal residence.**
No Bifurcation of an undersecured claim on the debtor's principal residence into secured and unsecured portions shall be allowed because bifurcation violates the principle of non-modification of rights of a creditor secured only by a security interest in the debtor's principal residence. See Section 1322 (b)(2) and

- D. **Case Law:**

United States Supreme Court Case:

6. **Nobleman v. American Sav. Bank, 508 U.S. 324 (1993):**

FACTS:

- Debtor sought to apply Section 506(a) and reduce mortgage on principal residence from \$71,335.00 to \$23,500.00 (FMV of the property).
--Creditor objected to the bifurcation of the claim into secured and unsecured portions.
--Debtor's proposed Ch. 13 plan was not confirmed.

RULING:

- No bifurcation of claims into secured/unsecured portions.
--Such a modification is not permitted by Section 1322(b)(2), regardless of Section 506(a).
--Section 1322(b)(2) prohibits Ch. 13 debtors from modifying the rights of residential mortgage creditors.

III. MINORITY VIEW (other jurisdictions):

- A. **Rule of Law:** A wholly unsecured lien on a principal residence may not be stripped off in Ch. 13 cases.
1. No modification of liens on principal residences. Statutory prohibition, see Section 1322 (b)(2).
2. Secured status is based on the existence of a lien

which is secured by the debtor's principal residence, and not by the value of the underlying collateral.

B. Case Law:

1. **American General Finance, Inc. v. Dickerson, 229 B.R. 539 (M.D.Ga. 1999):**

FACTS:

- Debtor filed a complaint against the junior creditor seeking to change the status of the lender's claim from secured to unsecured.
- The Court determined that there was no equity in the principal residence that extended beyond the senior creditor's claim.

RULING:

- Lien may not be stripped off.
- No modification of liens in principal residences.
- Claim is secured by mere existence of the lien, and not by the value of the underlying collateral.

CHAPTER 7

IV. MAJORITY VIEW (Maryland):

- A. Rule of Law: A wholly unsecured lien on a debtor's principal residence may not be stripped off in Chapter 7.

- The general principle in Bankruptcy is that liens on real property pass through Bankruptcy unaffected.

B. Case Law:

United States Supreme Court Case:

1. **Dewsnup v. Timm, 502 U.S. 410 (1992):**

FACTS:

- Debtor initiated adversary proceeding contending that the debt on the principal residence (\$120,000.00) exceeded the property's Fair Market Value (\$39,000.00).
- Debtor argued that the lien was void to the extent that it secured a claim against the debtor that was not an allowed secured claim.

RULING:

- The long established principal in Bankruptcy is that liens on real property pass through Bankruptcy unaffected. Therefore to allow a strip down, would undermine this policy.
- Section 506 does not allow a debtor to strip down the lien to the judicially determined value of the collateral.
- The creditor's claim is secured by a lien which has been fully allowed pursuant to Section 502.
- To allow a strip down, would freeze a creditor's rights in time, and the creditor would lose the

value of any appreciation in the collateral prior to foreclosure while the debtor would benefit from a windfall.

--The Court in its holding stated that this decision was limited to Ch. 7.

Maryland Cases:

2. **Cunningham, et al. v. Homecoming Financial Network, 246 B.R. 241 (Bkrtcy.D.Md. 2000):**

FACTS:

--Debtor's property was valued at \$137,500.00.
--1st lien was held by Homeside in an amount of \$155,449.52.
--2nd lien was held by Homecomings in an amount of \$47,626.99.
--3rd lien was held by Commercial Credit in an amount of \$10,334.28.
--4th lien was held by Household in an amount of \$10,069.17.
--Debtor initiated adversary proceeding to strip off junior deed of trust liens, alleging that they were wholly unsecured.
--The creditor moved to dismiss the Complaint and the Court granted the creditor's motion.

RULING:

--Wholly unsecured liens can not be stripped off in CH7.
--The debtor could not strip off a junior lien even though the value of the property was less than the amount of the senior deed of trust indebtedness.
--The Court followed the majority ruling in Dewsnap.
--In the opinion of the Court, "the language of Dewsnap allows no other result, even though this case involved wholly unsecured claims, which are sought to be stripped off as opposed to the undersecured claim in Dewsnap which was sought to be stripped down."

3. **Esler v. Orix Credit Alliance, 165 B.R. 583 (Bkrtcy.D.Md. 1994):**

FACTS:

--The debtor sought to avoid a judicial lien by bifurcating the creditor's claim under Section 506(a).

RULING:

--Stripping down UNDERsecured liens is PROHIBITED.
--Prohibition is equally applicable to consensual and nonconsensual liens.
--The debtor may avoid a judicial lien only to the extent that it impairs the homestead exemption pursuant to Section 522.

4. **Schroeder v. First Union Nat'l Bank, 182 B.R. 723 (D.Md. 1995):**

FACTS:

- The debtor sought to avoid a judicial lien because it impaired the homestead exemption.
- The creditor appealed the Bankruptcy Court's decision to allow the lien to be avoided in its entirety.

RULING:

- The secured judicial lien can not be avoided in its entirety.
- A debtor can only avoid the judicial lien to the extent that it impairs the allowable homestead exemption.
- The debtor gets the benefit of a fresh start by the voiding of the lien to the extent that it impairs the allowable exemption.

V. MINORITY VIEW (other jurisdictions):

- A. Rule of Law: A lien may be stripped off of a debtor's principal residence if it is wholly unsecured.

1. Debtor is able to avoid allowable liens when they are not secured.
2. Liens are only secured to the extent of the value of the interest in the collateral.
3. If there is no value in the collateral, the lien is not secured.

B. Case Law:

Virginia Case:

1. **Yi v. Citibank, N.A., 219 B.R. 394 (E.D.Va. 1998):**

FACTS:

- The debtor filed a complaint against a junior lienholder seeking to avoid the lien due to the fact that the senior lienholders' claims exceeded the property value.

RULING:

- The Court allowed the lien to be stripped off.
- A lien is a secured claim only to the extent of the value of the interest in the collateral.
- If there is no interest in the collateral, the claim is not secured.
- Avoidance of a creditor's lien did not constitute a 5th amendment taking.

PROCEDURE

VI. FEDERAL:

- A. A proceeding to value a secured creditor's collateral may be brought by motion (FRBP 3012).
- B. The motion must be served on the lien holder in same manner as Complaint and Summons (FRBP 9014 and 7004).
- C. Valuation and extinguishing a lien can not be accomplished through mere disclosure in a Ch. 13 plan without an affirmative action taken by the debtor.
- D. A creditor must be notified and given an opportunity to be heard regarding the potential effect on his interest.

VII. MARYLAND:

- A. New MD Rule 3012-1 aligns the procedure in cases under Ch. 13 to strip off wholly unsecured liens with the procedure used under LBR 4003-2 for avoiding liens that impair exemptions.
- B. MD Rule 4003-2 Lien Avoidance by motion. May only name one creditor per motion.
- C. Service of Motion (w/ Cert. of Service) and notice of hearing must be at least 50 days before the hearing in compliance with FBRP 9014 and 7004(b) and LBR 3007-1(a).
- D. Response to Motion must be within 25 days of service or motion may be ruled upon unopposed.
- E. Proposed Order must accompany Motion (see Form H).
- F. If motion to avoid lien is granted, the avoidance will occur at the time the debtor completes performance of his confirmed Ch. 13 plan and receives a discharge.

VIII. CONCLUSION:

- Lien stripping is a valuable tool in providing debtors with a "fresh start."
- Creditors must be aware that valuation is the key to preventing junior lien holders from losing the benefit of their bargains.
- Creditors, especially second lien holders, should be diligent in obtaining appraisals and presenting clear evidence of value at the hearings since a dollar of equity would save their lien from being avoided.